



Texas A&M University School of Law
Texas A&M Law Scholarship

Faculty Scholarship

1-2005

Rethinking Civil RICO: The Vexing Problem of Causation in Fraud-Based Claims Under 18 U.S.C. § 1962(c)

Randy D. Gordon

Texas A&M University School of Law, rdgordon@law.tamu.edu

Follow this and additional works at: <https://scholarship.law.tamu.edu/facscholar>



Part of the [Civil Procedure Commons](#), and the [Criminal Law Commons](#)

Recommended Citation

Randy D. Gordon, *Rethinking Civil RICO: The Vexing Problem of Causation in Fraud-Based Claims Under 18 U.S.C. § 1962(c)*, 39 USF L. Rev. 319 (2005).

Available at: <https://scholarship.law.tamu.edu/facscholar/1032>

This Article is brought to you for free and open access by Texas A&M Law Scholarship. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Texas A&M Law Scholarship. For more information, please contact aretteen@law.tamu.edu.

Rethinking Civil RICO: The Vexing Problem of Causation in Fraud-Based Claims Under 18 U.S.C § 1962(c)

By RANDY D. GORDON*

SINCE THE Racketeer Influenced and Corrupt Organizations (“RICO”) statute was enacted as Title IX of the Organized Crime Control Act of 1970,¹ academics and judges have spilled a sea of ink in the service of competing attempts to curb or expand its reach. Commentators have oscillated between widely separated poles, with one camp condemning RICO as “very possibly the single worst piece of legislation on the books”² or “the civil law’s Moby Dick”³ and the other lauding the statute as “the preferred remedy for victims of large-scale frauds.”⁴ Judges have found themselves variously ascribing to both positions, depending on the legal context; they often “enthusiastically

* B.A., M.A., Ph.D., University of Kansas; J.D., *cum laude*, Washburn University School of Law; LL.M. in international and comparative law, Parker School Honors, Columbia Law School. Mr. Gordon is a partner with Gardere Wynne Sewell LLP, a law firm headquartered in Dallas, Texas. He specializes in antitrust, civil RICO, and complex business litigation and was one of the counsel in the *Sandwich Chef/ Wall Street Deli* case. He thanks his co-counsel in that case for their insight into and analysis of many of the issues elaborated upon in this Article. Mr. Gordon is also an adjunct faculty member at Southern Methodist University, where he teaches graduate literature courses and antitrust law. He wishes to thank Josh Shuart, his research assistant and a soon-to-be associate of the firm, for his considerable contribution to the authorities cited below. The views expressed in this Article are the author’s alone and do not necessarily represent those of his firm or its clients.

1. Pub. L. No. 91-452, 84 Stat. 922 (1970).

2. Editorial, *Second Thoughts on RICO*, WALL ST. J., May 19, 1989, at A14; *see also* William H. Rehnquist, *Get RICO Cases Out of My Courtroom*, WALL ST. J., May 19, 1989, at A14.

3. Lee Applebaum, *Is There a Good Faith Claim for the RICO Enterprise Plaintiff?*, 27 DEL. J. CORP. L. 519, 522 n.16 (2002) (observing that “[f]or those trying to understand RICO’s history, nature, scope, and proper application, the statute can push the limits of comprehension”). The Melvillian allusion is to the memorable line “what the White Whale was to them, or how to their unconscious understandings . . . he might have seemed the gliding great demon of the seas of life,—all this to explain, would be to dive deeper than Ishmael can go.” HERMAN MELVILLE, *MOBY-DICK OR, THE WHALE* 184 (Hendricks House, Inc. 1952) (1851).

4. Michael Goldsmith & Evan S. Tilton, *Proximate Cause in Civil Racketeering Cases: The Misplaced Role of Victim Reliance*, 59 WASH. & LEE L. REV. 83, 98 (2002).

embrace[]” *criminal* RICO, while viewing *civil* RICO as “an anti-mafia law run amuck.”⁵

It is with respect to this latter point that critical ink has flowed most freely. All sides would probably agree that the debate over how, where, and whether to delimit RICO’s civil component admits of no easy solution and that the situation is worsened by the vague and complicated statutory text. While RICO was plainly designed to combat organized crime,⁶ the underlying problem is that its language may be read to apply as easily to the conduct of bankers and accountants as to wiseguys and goodfellas. Thus, the question is, Where does one draw the line between conduct that the statute will and will not reach?

This Article does not try to mediate every dispute over the applicability of civil RICO. Its goal is rather more modest—namely, to describe what limits the civil remedy provision of the RICO statute, 18 U.S.C. § 1964(c), places on fraud-based RICO claims. To do so, the Article revisits major Supreme Court milestones and considers whether, as many alarmists have recently declaimed, the lower courts generally disregard these milestones.

One way to approach these issues is to examine the requirement in § 1964(c) that any *civil* RICO claim be predicated on a demonstration that a substantive RICO violation *caused* the plaintiff’s alleged injuries. This statutory mandate to prove a causal link between act and injury is particularly important in class actions, because causation is difficult to prove on a class-wide basis where misrepresentations form the basis of the complained-of conduct. Historically, courts have agreed that fraud cases are presumptively noncertifiable when reliance is an element that must be pled and proven. Courts have therefore struggled to determine how or whether that presumption should bear on a fraud-based RICO class action claim. Countless disputes have erupted over the applicability and meaning of the reliance and causation nomenclature within the RICO context. This Article concludes that these disputes are too often staged at too high a level of abstraction, and they thus divert attention from the facts of individual cases.

To arrive at this conclusion, this Article explores a number of issues related to the causation element in civil RICO cases. Part I examines RICO’s purpose and explains the structure of a RICO-fraud

5. *Id.* at 92–93.

6. 84 Stat. at 923 (“It is the purpose of this Act to seek the eradication of organized crime in the United States.”); *see also* Beck v. Prupis, 529 U.S. 494, 496 (2000) (discussing the purpose of RICO).

claim. Part II introduces the standard for causation in a RICO context and discusses the questions left open by that standard. Part III looks closely at the element of causation in fraud-based RICO class actions to demonstrate why courts should make fact-specific inquiries, rather than apply broad generalizations to causation.

I. Civil RICO Overview

A. The Purpose and Development of Civil RICO Claims

As courts to this day often stress, RICO finds its genesis in a governmental desire to obliterate organized crime.⁷ The immediate source of RICO, Senate Bill 1861,⁸ was “designed to ‘prohibit the infiltration or management of legitimate organizations’ by means of racketeering activity as well as investment of the proceeds of racketeering activity in such organizations.”⁹ Late in the process, the House added a section providing for a private, treble damages right of action, which was modeled after section 4 of the Clayton Act.¹⁰ Criminal syndicate activity was also the aim of this section. Representative Sam Steiger, Arizona, urged that “those who have been wronged by organized crime should at least be given access to a legal remedy.”¹¹ The House Committee brushed aside the concerns of three of its members who feared the treble damages provision would “provide[] invitation for disgruntled and malicious competitors to harass innocent businessmen.”¹²

Against this backdrop, courts initially looked askance at civil RICO claims that could not be expressly linked to organized criminal activity. Several methods to limit RICO claims emerged: some courts held that civil RICO could be invoked only against organized crime;¹³

7. See sources cited *supra* note 6 and accompanying text.

8. S. Res. 1861, 91st Cong., 115 CONG. REC. 9512 (1969).

9. DAVID B. SMITH & TERRENCE G. REED, CIVIL RICO ¶ 1.01, at 1-4 (2004).

10. See Clayton Act of 1914, ch. 323, § 4, 38 Stat. 731 (codified as amended at 15 U.S.C. § 15). *Organized Crime Control: Hearings Before Subcommittee No. 5 of the House Comm. on the Judiciary*, 91st Cong. 543-44, 548, 559 (1970) [hereinafter *House Hearings*]; 116 CONG. REC. 25,190-91 (1970).

11. *House Hearings*, *supra* note 10, at 520 (statement of Rep. Steiger).

12. H.R. REP. NO. 91-1549, at 187 (1970), *reprinted* in 1970 U.S.C.A.N. 4007, 4083 (dissenting views of Reps. John Conyers, Jr., Abner Mikva, and William F. Ryan).

13. See, e.g., *Barr v. WUI/TAS, Inc.*, 66 F.R.D. 109, 113 (S.D.N.Y. 1975) (holding that “[i]t is clear that [RICO] was aimed not at legitimate business organizations but at combating ‘a society of criminals who seek to operate outside of the control of the American people and their governments[.]’” and concluding that because “[t]here is no question that defendant cannot be so characterized. . . . we find plaintiff’s proposed . . . claim for relief specious, frivolous and without merit” (citations omitted)).

others mandated proof of "competitive injury" as an element of standing;¹⁴ and yet others required a showing of "racketeering injury" caused by acts resulting in a "criminal conviction."¹⁵

The Supreme Court, however, swept these obstacles away in *Sedima, S.P.R.L. v. Imrex Co., Inc.*¹⁶ In *Sedima* the Court held that "[i]f the defendant engages in a pattern of racketeering activity in a manner forbidden by [the RICO statute], and the racketeering activities injure the plaintiff in his business or property, the plaintiff has a claim."¹⁷ In the wake of this broad holding, the battleground shifted to the requirement that injury to business or property be caused "by reason of" a violation of one of the four enumerated subparts of § 1962.¹⁸

This limitation on the statute's application remains today.¹⁹ The debate surrounding the "by reason of" element most often arises in cases of fraud-based RICO claims. These claims are alluring because

14. See, e.g., *N. Barrington Dev., Inc. v. Fanslow*, 547 F. Supp. 207, 210-11 (N.D. Ill. 1980).

15. See, e.g., *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482, 494-503 (2d Cir. 1984), *rev'd*, 473 U.S. 479 (1985).

16. 473 U.S. 479 (1985).

17. *Id.* at 495.

18. RICO § 1964 provides for civil remedies. See 18 U.S.C. § 1964 (2000). Section 1962 sets forth the four RICO offenses: three of which are substantive and one of which sounds in conspiracy. *Id.* § 1962. In essence, § 1962(a) was designed to prevent racketeers from using illicit money to purchase or operate legitimate businesses, § 1962(b) was designed to prohibit the takeover of legitimate businesses through racketeering acts (e.g., muscling in on a business through extortion or loan sharking), and § 1962(c) was intended to prevent the operation of a legitimate business through racketeering. See SMITH & REED, *supra* note 9, ¶ 5.01, at 5-2. Only rarely is a plaintiff able to sustain a claim under the first two subsections. This is so because § 1962(a) requires pleading and proof of an "investment injury" and § 1962(b) requires pleading and proof of an "acquisition or maintenance injury":

Under subsections (a) and (b), there must be a nexus between the claimed RICO violations and the injury suffered by the plaintiff. For subsection (a), this means that the injury must flow from the investment of racketeering income into the enterprise. . . . As to subsection (b), a plaintiff must show that his injuries were proximately caused by a RICO person gaining an interest in, or control of, the enterprise through a pattern of racketeering activity.

Crowe v. Henry, 43 F.3d 198, 205 (5th Cir. 1995) (citations omitted). Because § 1962(c) is the RICO offense most often charged, it is the sole substantive RICO violation discussed in this Article.

19. This is not to say that § 1964(c) presents the only obstacle to a civil claim. A careful examination of a range of opinions reveals that, at the analytical level, courts have parsed the RICO statute into words and phrases and found those constituents pregnant with meaning. Now, nearly every word in the statute has attained an independent significance and constitutes a separate element to be pled and proven. The author has outlined these elements elsewhere. See Randy D. Gordon, *Parsing Civil RICO: An Outline of Pleading and Proof Requirements for Fraud-Based Claims Under 18 U.S.C. § 1964(c)*, TEX. BUS. LITIG., Fall 2001, at 5, 5-12.

they offer, at least in theory, a way to predicate misrepresentation complaints on a federal statute that has elements that are at once uniform across the United States and different from those of common-law fraud.

B. Foundation of a Fraud-Based RICO Claim

To understand the importance of the “by reason of” (causation) element, it is important to consider at the outset the required foundation for a typical fraud-based RICO claim. While this discussion is by no means comprehensive, as fraud is not the only act upon which to predicate a claim, even a cursory review of the case law reveals that a significant percentage of civil RICO claims include a charge of fraud.²⁰

The § 1964(c) inquiry involves three steps. First, to establish that a defendant committed “racketeering activity,” as defined in § 1961(1) and required by § 1962(c), a plaintiff must show indictable acts (i.e., “predicate” acts) in violation of one of the enumerated statutes²¹—mail fraud,²² wire fraud,²³ and interstate transportation of fraudulently obtained money²⁴ are the most commonly asserted. Second, § 1962(c)²⁵ requires that a defendant must be a “person employed by or associated with an[] enterprise”²⁶ and that the

20. See *Wal-Mart Stores, Inc. v. Watson*, 94 F. Supp. 2d 1027, 1031 (W.D. Ark. 2000). (“[A] high percentage of civil RICO cases, unlike typical antitrust cases, involve fraud claims.” (quoting *Klehr v. A.O. Smith Corp.*, 521 U.S. 179, 191 (1997))). As of 1985, “of the 270 known civil RICO cases at the trial court level, 40% involved securities fraud, 37% common-law fraud in a commercial or business setting, and only 9% ‘allegations of criminal activity of a type generally associated with professional criminals.’” *Sedima*, 473 U.S. at 499 n.16 (quoting ABA SECTION OF CORP., BANKING, & BUS. LAW, REPORT OF THE AD HOC CIVIL RICO TASK FORCE 55–56 (1985)). Additionally, “[r]oughly two fifths [sic] of all civil actions under RICO are based on charges that the defendant committed mail or wire fraud.” Horace D. Nalle, Jr., *Civil RICO Claims Predicated on Mail or Wire Fraud: The Indispensability of Reliance*, 109 BANKING L.J. 272, 272 (1992).

21. See 18 U.S.C. §§ 1961(1), 1962(c), 1964(c) (2000); *Sedima*, 473 U.S. at 495 (stating that “‘racketeering activity’ consists of no more and no less than commission of a predicate act” listed in § 1961(1)).

22. See 18 U.S.C. § 1341.

23. See *id.* § 1343.

24. See *id.* § 2314.

25. Section 1962(c) is the most frequently charged violation of RICO. SMITH & REED, *supra* note 9, ¶ 5.01, at 5-2.

26. 18 U.S.C. § 1962(c). The concept of “enterprise” is the *sine qua non* of any RICO claim and the characteristic that distinguishes a RICO claim from an ordinary tort claim. See *Bonner v. Henderson*, 147 F.3d 457, 459 (5th Cir. 1998) (“By the very language of the statute, the existence of an enterprise is an essential element of a RICO claim.”); *Chang v. Chen*, 80 F.3d 1293, 1298–99 (9th Cir. 1996) (noting that RICO’s focus is on *organized* crime, therefore the finding of an *organizational nexus* is at the heart of a scheme actionable

defendant must have "conduct[ed] or participat[ed], directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity."²⁷ Third, under § 1964(c), a complaining civil party must be a "person injured in his business or property by reason of a violation of § 1962."²⁸

As this three-part framework suggests, a plaintiff must demonstrate crimes at two levels (i.e., at the predicate act level and at the § 1962 level) and have standing to seek redress for those crimes under § 1964(c).²⁹ Proof of RICO-fraud, then, must necessarily be multi-layered and certainly different in degree (and often greater in kind) than proof of common-law fraud.³⁰

under RICO); *United States v. Neapolitan*, 791 F.2d 489, 500 (7th Cir. 1986) ("The central role of the concept of enterprise under RICO cannot be overstated.").

RICO defines the term "enterprise" to include (1) "any individual, partnership, corporation, association, or other legal entity," and (2) "any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. § 1961(4).

An association-in-fact sufficient to satisfy the RICO enterprise requirement must meet three criteria: (1) it "must have an existence separate and apart from the pattern of racketeering;" (2) it "must be an ongoing organization;" and (3) "its members must function as a continuing unit as shown by a hierarchical or consensual decision making structure." *Goldin, Peiser & Peiser, L.L.P. v. Delta Brands, Inc.*, No. 3:02-CV-0127-M, 2002 WL 550450, at *3 (N.D. Tex. Apr. 11, 2002) (citing *Delta Truck & Tractor, Inc. v. J.I. Case Co.*, 855 F.2d 241, 244 (5th Cir.1988)).

27. 18 U.S.C. § 1962(c). Again, § 1962(c) is intended to prevent the operation of a legitimate business through racketeering. See SMITH & REED, *supra* note 9, ¶ 5.01, at 5-2. It thus forbids any person from conducting the affairs of an enterprise through a pattern of racketeering. 18 U.S.C. § 1962(c) (emphasis added). Consequently, "to state a violation of subsection (c), the alleged RICO person and the alleged RICO enterprise must be distinct." *Andrews v. Am. Nat'l Red Cross, Inc.*, 176 F. Supp. 2d 673, 687 (W.D. Tex. 2001). Thus, plaintiffs would need to "plead specific facts which establish that the association exists for purposes other than simply to commit the predicate acts." *Elliott v. Fofas*, 867 F.2d 877, 881 (5th Cir. 1989) (emphasis added); see also *Bachman v. Bear, Stearns & Co., Inc.*, 178 F.3d 930, 932 (7th Cir. 1999) ("That is a conspiracy, but it is not an enterprise unless every conspiracy is also an enterprise for RICO purposes, which the case law denies.").

28. 18 U.S.C. § 1964(c).

29. Teresa Bryan et al., *Racketeer Influenced and Corrupt Organizations*, 40 AM. CRIM. L. REV. 987, 1030-33 (2003).

30. For instance, a plaintiff must show that the predicate acts alleged are related and that they "amount to or pose a threat of continued criminal activity." *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 239 (1989). Thus a single act of fraud—even one with enormous consequences—is beyond RICO's purview. By contrast, common-law fraud generally consists of three elements: (1) a material false statement made with an intent to deceive; (2) the victim's justifiable reliance on the statement; and (3) damages. See RESTATEMENT (SECOND) OF TORTS § 525 (1977). Most—if not all—jurisdictions have adopted some variation of this language. For example, to establish fraud under Texas law, a plaintiff must demonstrate the following:

(1) a material representation was made; (2) the representation was false; (3) the speaker made the representation knowing it was false or made it recklessly without any knowledge of its truth and as a positive assertion; (4) the speaker made

C. Introduction to the Problem of Causation: The Anatomy of a RICO Claim Based on Mail or Wire Fraud

The multi-layered structure required to prove RICO-fraud can be demonstrated by examining RICO claims based on mail or wire fraud. An examination of how these claims are structured also introduces the debate about whether reliance is required to prove causation in fraud-based RICO actions.

Many academic discussions of fraud-based claims proceed from the false premise that civil RICO provides a universal private right of action for violations of the federal mail and wire fraud statutes.³¹ This, however, ignores both the substantive elements of § 1962(c) and the standing requirements of § 1964(c). The inquiry is more complicated. A plaintiff must do more than show that a defendant committed an act for which the government could indict him under the mail or wire fraud statutes. He must first show that this mail or wire fraud was part of a "pattern of racketeering."³² Next, he must demonstrate a nexus between this pattern and the operation of an "enterprise" for which, again, the government could indict him.³³ Yet this is still not enough. Finally, the plaintiff must go further and establish that he suffered injury "by reason of" these indictable acts.³⁴

Litigating under this framework suggests that advancing or defending a civil RICO claim is akin to playing three-dimensional chess: sections 1961, 1962, and 1964 become separate, though related, battlegrounds. Much confusion has arisen out of this three-part structure, particularly with respect to questions of how, or precisely at what point, a plaintiff must demonstrate causation. At least part of the problem springs from the difference between what the government must prove to convict a defendant of mail or wire fraud and what a private plaintiff must prove to recover for that same fraud. Many litigants and commentators—either by design or indifference—do not

the representation with the intention that it should be relied upon by the party; (5) the party acted in reliance upon the misrepresentation; and (6) the party thereby suffered injury.

Norman v. Apache Corp. 19 F.3d 1017, 1022 (5th Cir. 1994).

31. See generally Courtney Chetty Genco, Note, *Whatever Happened to Durland?: Mail Fraud, RICO, and Justifiable Reliance*, 68 NOTRE DAME L. REV. 333 (1992); Goldsmith & Tilton, *supra* note 4; Michael A. Hanzman, *Establishing Injury "By Reason Of" Racketeering Activity*, FLA. BUS. J., Mar. 2003, at 36.

32. 18 U.S.C. § 1962(c).

33. *Id.*

34. *Id.* § 1964(c).

appreciate the importance of RICO's structure.³⁵ Consequently, they accuse courts of wild inconsistency in the causation standards applicable in private RICO-fraud cases.³⁶ This is especially true with respect to whether reliance must be proven in a RICO-fraud case. A close textual reading, however, resolves most of the putative inconsistencies by revealing that there are two distinct lines of cases as to whether and when reliance must be proven: one line makes pronouncements about the elements of mail and wire fraud, the other about the meaning of § 1964(c)'s "by reason of" standard.

The root of the problem is found in the difference between mail or wire fraud and common-law fraud. There are important differences between the two, but the gulf is not nearly as wide as many have argued.³⁷ True, for decades courts have applied the mail and wire fraud statutes to conduct that would not constitute fraud at common law because the conduct did not involve a misrepresentation.³⁸ This appli-

35. Instead, they needlessly debate the issue of reliance. *See, e.g.*, Goldsmith & Tilton, *supra* note 4, at 88 (asserting that "lower courts have erroneously . . . [ruled] that RICO requires proof of reliance[;]" that "reliance is not an element of mail and wire fraud[;]" and that "courts have nevertheless read reliance into the RICO statute"). Not surprisingly, most RICO-fraud plaintiffs tend to promote this reading of the statute. *See, e.g.*, Heden v. Hill, 937 F. Supp. 1230, 1243 (S.D. Tex. 1996). In *Heden*, the court denied class certification in part because, "[u]nlike in criminal RICO prosecutions, civil RICO plaintiffs must allege and prove reliance in cases using the mail and wire fraud statutes as predicate offenses." *Id.* In this case, the court found that "although there [was] evidence presented concerning misrepresentations or omissions of material fact" by the defendant, the plaintiff "[did] not show that these misrepresentations or omissions were made to him, either by mail or wire, or relied upon by him." *Id.*

Other lower courts, however, have subscribed to misguided logic. District courts in the Seventh Circuit, for example, have repeatedly certified RICO classes predicated on mail or wire fraud after stating that proof of reliance is not required. *See, e.g.*, Garner v. Healy, 184 F.R.D. 598, 602 n.4 (N.D. Ill. 1999) ("[I]ndividual reliance [is not] an element of a RICO claim based upon mail and wire fraud."); *In re Synthroid Mktg. Litig.*, 188 F.R.D. 295, 300 (N.D. Ill. 1999) ("Individual reliance is not an element of a claim . . . under RICO that is predicated on acts of mail and wire fraud . . ."); Johnson v. Aronson Furniture Co., No. 96 C 117, 1998 WL 641342, at *8 (N.D. Ill. Sept. 11, 1998) ("Individual reliance . . . is not an element of a RICO claim based on mail fraud . . ."); Ruiz v. Stewart Assocs., Inc., 171 F.R.D. 238, 240-41 (N.D. Ill. 1997) ("RICO requires only causation, not reliance.").

36. As we shall also see, though, some courts have announced standards that, if taken literally and applied across the board, would stifle claims that should be actionable.

37. *See, e.g.*, Genco, *supra* note 31, at 335-36 (arguing that "[d]espite the Supreme Court's clear teachings, the circuit courts are mistakenly reading common-law limitations taken from the jurisprudence of the crime of obtaining property by false pretenses and the tort of deceit into the law of mail fraud when it is civilly enforced through [RICO]").

38. *See, e.g.*, United States v. Manzer, 69 F.3d 222, 226-27 (8th Cir. 1995) (unauthorized selling of satellite broadcasting decryption devices); United States v. Lang, 904 F.2d 618, 627 (11th Cir. 1990) (check kiting—a process used to deprive banks of money); Atlas Pile Driving Co. v. DiCon Fin. Co., 886 F.2d 986, 991 (8th Cir. 1989) (manipulation of contract payments); Carpenter v. United States, 484 U.S. 19, 27, 28 (1987) (embezzlement

cation has arguably been based on misreadings of *Durland v. United States*,³⁹ the seminal case interpreting the mail fraud statute. But this application is at once wrong and, as a practical matter, irrelevant. First, in *Neder v. United States*,⁴⁰ the United States Supreme Court recently confirmed that (1) the mail fraud statute incorporated the well-settled common law requirement that a fraud claim be based on "a misrepresentation or concealment of material fact"⁴¹ and (2) *Durland* did not cast its net as widely as some had supposed. The Court stated:

[In *Durland* w]e rejected the argument that "the statute reaches only such cases as, at common law, would come within the definition of 'false pretenses,' in order to make out which there must be a misrepresentation as to some existing fact and not a mere promise as to the future." Instead, we construed the statute to "includ[e] everything designed to defraud by representations as to the past or present, or suggestions and promises as to the future." Although *Durland* held that the mail fraud statute reaches conduct that would not have constituted "false pretenses" at common law, it did not hold . . . that the statute encompasses more than common-law fraud.⁴²

Second, even a cursory review of case law demonstrates that nearly every fraud-based RICO claim is predicated on an allegation that someone lied—either affirmatively or by omission—about something. Thus, objections that the federal fraud statutes reach conduct beyond that involving misrepresentations are more apparent than real.

Now this is not to say that the *elements* of mail or wire fraud are coterminous with common-law fraud. Mail fraud and wire fraud do not require proof of reliance or damages,⁴³ because those statutes are designed to strike preemptively, as well as retrospectively, at fraud. The Supreme Court stated that "[b]y prohibiting the 'scheme to defraud' rather than the completed fraud, the elements of reliance and damages would clearly be inconsistent with the statutes that Congress enacted."⁴⁴ Accordingly, for years courts have held that a RICO plaintiff need not prove reliance to establish predicate acts of mail or wire

and misappropriation of information); *United States v. Fischl*, 797 F.2d 306, 311 (6th Cir. 1986) (kickback scheme); *United States v. Buckley*, 689 F.2d 893, 899–900 (9th Cir. 1982) (money laundering); *Shushan v. United States*, 117 F.2d 110, 115 (5th Cir. 1941) (bribery); see also Goldsmith & Tilton, *supra* note 4, at 87.

39. 161 U.S. 306 (1896).

40. 527 U.S. 1 (1999).

41. *Id.* at 3 (emphasis omitted).

42. *Id.* at 24 (citations omitted).

43. *Id.* at 24–25.

44. *Id.* at 25.

fraud.⁴⁵ Nevertheless, this rule begs the ultimate question presented by this Article—specifically, What must a plaintiff prove to show that he was injured “by reason of” those predicate acts?

II. The Importance of Causation in Civil RICO

The importance of particular elements of a civil RICO claim has shifted over time. While courts in the 1980s placed particular emphasis on RICO's pattern and injury requirements,⁴⁶ the current emphasis has been on civil RICO's causation standard, which derives from § 1964(c)'s “by reason of” language. In particular, the courts have debated the question of whether a plaintiff must prove reliance to establish a claim. This question has gained special importance in the class-action context, where any claim that requires individual proof of reliance sounds the death knell for a putative class.⁴⁷ Any satisfactory answer must therefore consider (1) the threshold standards for proving RICO causation, (2) the extent to which reliance bears on particular types of cases, and (3) how these sub-issues impact the possibility of class-certification of RICO-fraud claims. In conducting this analysis, it is helpful to recall that RICO's civil remedies provision is narrower than both RICO's criminal provision and ordinary civil fraud.

It is one thing to argue that Congress decided to combat fraud by empowering the government to prosecute and punish false statements in commercial or consumer transactions without proving that the citi-

45. See, e.g., *Armco Indus. Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475, 482 (5th Cir. 1986) (distinguishing RICO mail fraud from common-law fraud and stating that “[t]o find a violation of the federal mail fraud statute it is not necessary that the victim have detrimentally relied on the mailed misrepresentations”).

46. The focus on RICO's pattern requirement stemmed largely from “the celebrated footnote 14 of the *Sedima* decision and that footnote's enigmatic suggestion that the statutory definition of a ‘pattern of racketeering activity’ could provide a key to confining the scope of RICO, particularly in its civil applications.” See PAUL A. BATISTA, *CIVIL RICO PRACTICE MANUAL* § 2.19, at 34 (2d ed. 1997) (discussing *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 496 n.14 (1985)). “Literally hundreds—if not several thousand—of reported federal decisions between 1985 and 1989 considered *Sedima*'s footnote 14 and its terse discussion of the definition of a ‘pattern of racketeering activity.’” *Id.* at 34 n.73. The *Sedima* Court also rejected the notion that a private plaintiff must establish a special “racketeering injury”—an injury distinct from any injury arising from the predicate acts themselves. *Sedima*, 473 U.S. at 495. In reaction to a rapid increase in private civil RICO actions during the early 1980s, various federal district courts prior to *Sedima* had required civil plaintiffs to allege a racketeering injury, racketeering enterprise injury, or competitive injury distinct from any injury caused directly by the defendant's commission of the predicate acts. See John L. Koenig, Comment, *What Have They Done to Civil RICO: The Supreme Court Takes the Racketeering Requirement Out of Racketeering*, 35 AM. U. L. REV. 821, 824–27 (1986).

47. For a specific discussion of class-action issues, see *infra* Part III.

zenry relied on those false statements. It is quite another thing, however, to maintain that Congress intended RICO to permit a private party to recover treble damages for a false statement upon which *no one* relied. Indeed, it is difficult to imagine a false statement that could cause injury without *someone* believing the statement and acting in reliance on it.⁴⁸ In most cases, causation and reliance amount to the same thing.⁴⁹ Even the exceptions that follow do not suggest that reliance has no place in the analysis of a RICO claim.

A. The General Standards for Proof of Causation Provided by *Holmes*

Plaintiffs may recover civilly for RICO violations only if they can demonstrate injury “by reason of” those violations.⁵⁰ The United States Supreme Court first construed this standard in *Holmes v. Securities Investor Protection Corp.*⁵¹ In *Holmes*, the plaintiff, Securities Investor Protection Corporation (“SIPC”), which was a private nonprofit corporation formed under the Securities Investor Protection Act of 1980 and designed to restore funds to investors with assets in the hands of failed brokerage firms, paid several million dollars to cover claims of customers of two failed broker-dealers.⁵² SIPC alleged that seventy-five defendants participated in a fraudulent stock-manipulation scheme involving six companies.⁵³ This scheme caused the two broker-dealers to fail.⁵⁴ SIPC sued as the subrogee of the customers of the broker-dealers who had *not* purchased the manipulated securities but were nonetheless injured when the broker-dealers collapsed.⁵⁵ The Court was thus called upon to decide whether a plaintiff has standing to sue for a RICO violation inflicted on a third party where the third party’s injury in turn injures the plaintiff.⁵⁶ The legal question presented was

48. See, e.g., *In re Mastercard Int’l Inc.*, 132 F. Supp. 2d 468, 496 (E.D. La. 2001) (“As to the alleged wire fraud, plaintiffs do not even allege that they were aware of such activities; therefore plaintiffs could not rely upon an activity of which they were not aware.”); 3 JOHN NORTON POMEROY, EQUITY JURISPRUDENCE § 890 (Spencer W. Symons ed., 5th ed. 1941) (“Unless an untrue statement is believed and acted upon, it can occasion no legal injury.”).

49. In logical terms reliance is often sufficient to prove causation, even though it may not always be necessary to do so. The calculus is, however, rather more complicated than this formulation would suggest. See *infra* Part II.B.

50. 18 U.S.C. § 1964(c) (2000).

51. 503 U.S. 258 (1992).

52. See *id.* at 261–63.

53. *Id.* at 262–63.

54. See *id.* at 261.

55. See *id.* at 261–62.

56. See *id.* at 265.

framed as whether a showing of but-for causation is sufficient to confer standing.⁵⁷

At the outset, the Court acknowledged that the statute's "language can . . . be read to mean that a plaintiff is injured 'by reason of' a RICO violation, and therefore may recover, simply on showing that the defendant violated § 1962, the plaintiff was injured, and the defendant's violation was a 'but for' cause of plaintiff's injury."⁵⁸ Yet the Court quickly dismissed this literal reading, principally based on an inference of Congressional intent.⁵⁹

As noted earlier, Congress modeled § 1964(c) on section 4 of the Clayton Act, which is the civil action provision of the antitrust laws.⁶⁰ That provision was in turn modeled on section 7 of the Sherman Act.⁶¹ Both section 7⁶² and section 4⁶³ had been held to "incorporate common-law principles of proximate causation."⁶⁴ The *Holmes* court thus easily found that this reasoning based on statutory pedigree applied just as readily to § 1964(c):

We may fairly credit the 91st Congress, which enacted RICO, with knowing the interpretation federal courts had given the words earlier Congresses had used first in § 7 of the Sherman Act and later in the Clayton Act's § 4. It used the same words, and we can only

57. See *id.* at 265-66.

58. *Id.*

59. *Id.* at 266 ("This construction is hardly compelled, however, and the very unlikelihood that Congress meant to allow all factually injured plaintiffs to recover persuades us that RICO should not get such an expansive reading.").

60. See Clayton Act of 1914, ch. 323, § 4, 38 Stat. 731 (codified as amended at 15 U.S.C. § 15 (1982)); *Holmes*, 503 U.S. at 267 ("We have repeatedly observed that Congress modeled § 1964(c) on the civil-action provision of the federal antitrust laws [and] § 4 of the Clayton Act" (citations omitted)).

61. "Congress enacted § 4 in 1914 with language borrowed from § 7 of the Sherman Act, passed 24 years earlier." *Holmes*, 503 U.S. at 267 (citing *Associated Gen. Contractors v. Cal. State Council of Carpenters*, 459 U.S. 519, 530-33 (1983)). See Sherman Antitrust Act, ch. 647, § 7 (1890) (codified as amended at 15 U.S.C. § 7).

62. *Id.* (citing *Associated Gen. Contractors*, 459 U.S. at 533-534 & n.29); see also *Loeb v. Eastman Kodak Co.*, 183 F. 704, 709 (3d Cir. 1910) (holding that as a matter of law, a stockholder and creditor of a corporation that was injured by an antitrust violation could not recover treble damages under section 7 because the stockholder's injury was too "indirect, remote, and consequential"); *Ames v. Am. Tel. & Tel. Co.*, 166 F. 820, 823 (C.C.D. Mass. 1909) (holding that a plaintiff whose stock was rendered worthless during an illegal corporate takeover had no legally cognizable section 7 claim because the injury to the stockholder could not be distinguished from any injury sustained by the company itself).

63. *Holmes*, 503 U.S. at 267-68. Congressional use of the section 7 language in section 4 had led the Court to conclude in *Associated General Contractors* that "a plaintiff's right to sue under § 4 required a showing that the defendant's violation not only was a 'but for' cause of his injury, but was the proximate cause as well." *Id.* (citing *Associated Gen. Contractors*, 459 U.S. at 534).

64. *Id.* at 267.

assume it intended them to have the same meaning that courts had already given them.⁶⁵

Reasoning from this historical perspective, the Court concluded that “[p]roximate cause is thus required.”⁶⁶

The Court, however, declined to articulate a specific test for determining proximate cause; instead, it opted to employ the term as a generic shorthand for “the judicial tools used to limit a person’s responsibility for the consequences of that person’s own acts.”⁶⁷ In a brief elaboration on this limitation-of-liability theme, the Court referred to three policy objectives, discernable from analogous antitrust cases. These objectives were served by the common-law rule that demands “some direct relation between the injury asserted and the injurious conduct alleged.”⁶⁸ First, “the less direct an injury is, the more difficult it becomes” to differentiate damages stemming from a violation from those that are attributable to other factors.⁶⁹ Second, indirect injuries create apportionment problems because recognizing both direct and indirect injuries raises the specter of double recoveries.⁷⁰ Third, those directly injured may generally be counted on to serve as private attorneys general.⁷¹

Ultimately, since the *Holmes* decision, it is clear that a plaintiff who complains of harm “merely from the misfortunes visited upon a third person” will “stand at too remote a distance to recover.”⁷² It is also true, however, that the Court refused “to announce a black-letter

65. *Id.* at 268 (citations omitted).

66. *Id.*

67. *Id.* The Court observed that “[a]t bottom, the notion of proximate cause reflects ‘ideas of what justice demands, or of what is administratively possible and convenient.’” *Id.* (quoting *W. PAGE KEETON ET AL., PROSSER & KEETON ON TORTS* § 41, at 264 (5th ed. 1984)).

68. *Id.* As one leading nineteenth-century treatise explained:

The chief and sufficient reason for this rule is to be found in the impossibility of tracing consequences through successive steps to the remote cause, and the necessity of pausing in the investigation of the chain of events at the point beyond which experience and observation convince us we cannot press our inquiries with safety.

THOMAS M. COOLEY, *LAW OF TORTS* 73 (2d ed. 1888).

69. *Holmes*, 503 U.S. at 269.

70. *Id.*; see also *Associated Gen. Contractors*, 459 U.S. at 533–44; *Blue Shield of Va. v. McCready*, 457 U.S. 465, 473–475 (1982); *Hawaii v. Standard Oil Co. of Cal.*, 405 U.S. 251, 264 (1972).

71. *Holmes*, 503 U.S. at 269–70 (citing *Associated Gen. Contractors*, 459 U.S. at 542).

72. *Id.* at 268–69; see also 1 J.G. SUTHERLAND, *A TREATISE ON THE LAW OF DAMAGES* 55–56 (1882). Sutherland states:

Where the plaintiff sustains injury from the defendant’s conduct to a third person, it is too remote, if the plaintiff sustains no other than a contract relation to such third person, or is under contract obligation on his account, and the injury consists only in impairing the ability or inclination of such third person to perform his part, or in

rule" and that it would "not rule out" that third parties could state a claim of fraud.⁷³ It is within this gap between the general rule against third-party claims and the refusal to categorically rule them out that litigants have generated the most friction.

B. The Relationship Between Reliance and Causation Left Uncertain by *Holmes*

Although *Holmes* definitively settled the then-open question of whether both but-for and proximate causation must be pled and proven in a civil RICO case, it did little concretely to explain exactly how plaintiffs must do so, especially in misrepresentation cases. The Court did, however, set forth principles sufficient to guide further analysis. The key is, as learned from *Holmes*, the common law.

The common law did not develop a one-size-fits-all causation standard. For instance, relatively more remote consequences may be actionable when a causal act was intentional, as opposed to merely negligent.⁷⁴ Additionally, when an intentional act is a misrepresentation—as opposed to a tortious act whose consequences can be more clearly traced from act to injury (battery, for example)—the common law came to demand proportionality of remedy.⁷⁵ Consequently, not every recipient of a misrepresentation may recover:

One who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation, for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced.⁷⁶

Thus, "[i]f the misrepresentation has not in fact been relied upon by the recipient in entering into a transaction in which he suffers pecuniary loss, the misrepresentation is not in fact a cause of the loss."⁷⁷

The Second Restatement therefore combines misrepresentation, reliance, and causation in a negative way. It does not say that causa-

increasing the plaintiff's expense or labor of fulfilling such contract, unless the wrongful act is willful for that purpose.

Id. at 55.

73. *Holmes*, 503 U.S. at 272 nn.19–20.

74. RESTATEMENT (SECOND) OF TORTS § 435B cmt. a (1965) ("[R]esponsibility for harmful consequences should be carried further in the case of one who does an intentionally wrongful act than in the case of one who is merely negligent or is not at fault.").

75. See *Moore v. PaineWebber Inc.*, 189 F.3d 165, 176–78 (2d Cir. 1999) (Calabresi, J., concurring); David A. Curran, *Funds v. Big Tobacco and the Proximate-Cause Issue: A Framework for Derivative Injuries*, 80 TEX. L. REV. 393, 404–05 (2001).

76. RESTATEMENT (SECOND) OF TORTS § 531 (1977).

77. *Id.* § 546 cmt. a.

tion must be proven by a demonstration of reliance. Rather, it states that causation cannot be proven if a misrepresentation was not relied upon. This distinction seems to elude those who argue that the entire concept of reliance is "misplaced" in a RICO analysis.⁷⁸ In any event, the Restatement view, which turns on the related notions of transactional inducement and loss causation, helps clarify what but-for and proximate causation should mean in a fraud-based RICO claim.

The Second Circuit has a well-developed body of case law that considers the various faces of causation. In *Moore v. PaineWebber, Inc.*,⁷⁹ the Second Circuit held that a RICO plaintiff must plead and prove both "transaction causation" and "loss causation."⁸⁰ To show transaction causation, the court explained that "the plaintiffs must demonstrate that *but for* the defendant's wrongful acts, the plaintiffs would not have entered into the transactions that resulted in their losses."⁸¹ Meanwhile, to show loss causation "the plaintiffs must show that the defendants' misstatements or omissions were 'the reason the transaction[s] turned out to be . . . losing one[s].'"⁸² In a lengthy concurrence, Judge Calabresi elaborated on this holding and provided a helpful discussion of RICO causation in the relatively familiar terms of common-law tort causation.⁸³

78. See Goldsmith & Tilton, *supra* note 4, at 83.

79. 189 F.3d 165 (2d Cir. 1999).

80. *Id.* at 171-72.

81. *Id.* at 172.

82. *Id.* (quoting *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 769 (1994)).

83. Judge Calabresi stated:

For a fraud-related RICO suit to lie, the plaintiffs must show transaction causation. To do this, it is frequently said, the plaintiff must demonstrate that *but for* the defendant's wrongful acts the plaintiff would not have entered into the transaction that resulted in his or her losses. . . .

For purposes of proving transaction causation, but-for cause is typically treated as both a necessary and a sufficient condition. . . .

. . . .

But showing that the defendant's wrongful acts led the plaintiffs to enter into the transaction is not enough. For a RICO suit to lie, the plaintiffs must also demonstrate that the defendant's wrongful acts were responsible for the *loss* that occurred. The plaintiffs must, in other words, demonstrate with respect to that loss, the existence of all three of the traditional common-law elements of causation (but-for, causal link, and proximate cause). This jurisdictional requirement, which is normally termed "loss causation," is, in fact, not significantly different from the standard tort law requirement that a defendant's acts cause not only an accident but also the injury to the plaintiff that followed from the accident. In the typical common-law negligence context, however, the showing of causality with respect to the accident usually suffices to demonstrate causality with respect to the injury, and so the causal requirements are not given separate names.

In sum, plaintiffs must show that a misrepresentation or omission *caused* them to enter into a transaction and that the misrepresentation or omission *caused* a pecuniary loss. Framed in this clear fashion, RICO's causation requirement—whether articulated in terms of reliance or not—necessarily has an enormous impact on pleading and proof standards.⁸⁴

III. Reliance, Causation, and the Question of Certifiability of Fraud-Based RICO Claims Under Rule 23(b)(3)⁸⁵: *Holmes's Impact on Class Certification in Civil RICO Cases*

The elephant in the room during many discussions of RICO causation is the context in which the standard for proving causation matters most: class actions. No one has credibly argued that strict causation standards (often stated in terms of reliance) have proved an impediment to otherwise meritorious *individual* suits. The same cannot be said of strict causation standards in class actions. Therefore, it is important to consider this important contextual issue.

In the wake of a series of cases from the 1990s, most notably *Castano v. American Tobacco Co.*⁸⁶ and *In re Rhone-Poulenc Rorer Inc.*,⁸⁷ it has

What is true in negligence cases is also true in fraud cases (and hence in RICO-fraud cases) insofar as but-for cause is concerned. Thus, in the typical fraud case, but for the plaintiff's entry into the transaction, he or she would not have suffered the loss at all. With respect to this element of causation, therefore, what is needed to show transaction causation normally suffices to prove loss causation as well. And a showing that, absent the defendant's wrongdoing, the plaintiff would not have been part of the deal that went wrong is enough to show the requisite *sine qua non* relationship to the loss suffered.

It is quite different with respect to the second element, *i.e.*, causal link or tendency. This requirement, which is rarely a problem in the standard negligence case, is not infrequently the essence of the loss-causation question in a fraud situation, and therefore in a RICO-fraud case.

Id. at 174–76 (Calabresi, J., concurring) (citations and footnotes omitted).

84. Some courts equate transaction causation with reliance. See D.E. & J L.P. v. Conway, 284 F. Supp. 2d 719, 747 (E.D. Mich. 2003). “‘Transaction causation,’ *another way of describing reliance*, is established when the misrepresentations or omissions cause the plaintiff to engage in the transaction in question. As such, transaction causation is akin to ‘actual’ or ‘but for’ causation.” *Id.* (citing Robbins v. Kroger Props., Inc., 116 F.3d 1441, 1447 (11th Cir. 1997) (emphasis added)). Other courts associate reliance with proximate cause. See Sandwich Chef of Tex., Inc. v. Reliance Nat’l Indem. Ins. Co., 319 F.3d 205, 219 (5th Cir. 2003) (“Proximate cause generally demands that a misrepresentation be relied upon by the plaintiff, individually.”).

85. FED. R. CIV. P. 23(b)(3).

86. 84 F.3d 734 (5th Cir. 1996).

87. 51 F.3d 1293 (7th Cir. 1995).

become nearly impossible to certify *nationwide* classes based on *state* statutory or common law.⁸⁸ Plaintiffs have thus begun to cast about for a federal law to avoid this difference-in-state-law obstacle. At least facially, RICO is an attractive option because it provides a vehicle from which to assert fraud claims. But in many cases, plaintiffs have found that they have merely traded the variations-in-state-law roadblock for another—namely, the difficulty of proving causation on a class-wide basis. Thus, it is imperative to review the most often discussed cases and determine whether the causation problem is one that springs from the structure of the RICO statute itself or whether, as some have argued,⁸⁹ this problem has arisen from mis- or over-readings of *Holmes's* proximate cause requirement.

The debate is typically framed in terms of whether a plaintiff must show reliance on allegedly fraudulent statements or omissions.⁹⁰ At first blush, the circuit courts seem to be divided on the question. At one extreme, the First Circuit recently held that

reliance is a specialized condition that happens to have grown up with common law fraud. Reliance is doubtless the most obvious way in which fraud can cause harm, but it is not the only way There is no good reason here to depart from RICO's literal language by importing a reliance requirement into RICO.⁹¹

At the other extreme, the Eleventh Circuit periodically reaffirms its earlier pronouncement that a civil RICO plaintiff alleging mail or wire fraud as predicate acts "must prove that he was 'a target of the scheme to defraud' and that he 'relied to his detriment on misrepresentations made in furtherance of that scheme.'"⁹²

Although their outcomes are seemingly contradictory, these cases do not lead to the conclusion that the courts are irretrievably split. Rather, the courts appear to be making the sort of case-by-case inquiries inherent in the *Holmes* Court's decision to eschew a bright-line test for determining causation. Moreover, the lower courts are, quite sensi-

88. "Based primarily on the burden of applying multiple states' laws, an overwhelming number of federal courts have denied certification of nationwide state-law class actions." Rory Ryan, Comment, *Uncertifiable?: The Current Status of Nationwide State-Law Class Actions*, 54 BAYLOR L. REV. 467, 470 & n.5 (2002) (citing roughly seventy federal cases since 1985—among them *Castano* and *Rhone-Poulenc*—denying class certification for this reason).

89. See, e.g., Goldsmith & Tilton, *supra* note 4, at 103–04 (arguing that "courts have ignored the expansive evolution of fraud legislation and have adopted precisely the formalistic approach to proximate cause that *Holmes* eschewed").

90. See *supra* Part I.C.

91. Sys. Mgmt., Inc. v. Loiselle, 303 F.3d 100, 104 (1st Cir. 2002).

92. Sikes v. Teleline, Inc., 281 F.3d 1350, 1360 (11th Cir. 2002) (quoting Pelletier v. Zweifel, 921 F.2d 1465, 1499–1500 (11th Cir. 1991)); see also Andrews v. Am. Tel. & Tel. Co., 95 F.3d 1014, 1025 (11th Cir. 1996).

bly, developing schemes for analyzing causation by the category of fraud, for instance, based on certain recurring patterns involving the person to whom an alleged misrepresentation was made.

A. Class Action Certification of RICO-Fraud Claims Does Not Turn on the Issue of Reliance

Because no one can credibly argue that reliance is an element that must be pled and proven in every conceivable case,⁹³ in many respects, the debate over whether reliance is an element of fraud-based RICO claims is more important in theory than in practice. Just as certainly, no one can credibly argue that reliance is irrelevant in a case hinging on misrepresentations or omissions. Why does all this matter? Again, the reliance requirement impacts class actions. There is a well-developed body of general fraud law holding that no fraud claim can be certified as a class action if individual reliance must be proven at trial.⁹⁴ Absent a presumption of reliance (or some other way of demonstrating reliance with common proof), fraud cases cannot be certified.

Given this obstacle, plaintiffs have seized on two distinguishing features of RICO (as opposed to common-law) fraud. First, the predicate act of mail or wire fraud does not require proof of reliance.⁹⁵ Second, the standing requirement of civil RICO is defined in terms of causation, not reliance.⁹⁶ By invoking these key distinctions, plaintiffs hope to distinguish between their RICO claims and ordinary fraud claims, the latter of which they often readily concede to be uncertifiable under existing precedent. But do these distinctions really matter? Furthermore, have the courts, as several commentators have suggested, made a mess of this corner of the law and established wildly different standards? The best way to answer these questions is to examine the most often discussed cases.

In many cases, the litigants talk past one another. Plaintiffs take the flat-footed position that certification should be liberally granted because RICO claims do not require proof of reliance. Defendants, on the other hand, take the equally extreme position that RICO claims

93. See Goldsmith & Tilton, *supra* note 4, at 126 ("[V]ictim reliance is sufficient—but not always necessary—to show proximate cause.").

94. See, e.g., *Castano v. Am. Tobacco Co.*, 84 F.3d 734, 745 (5th Cir. 1996) ("[A] fraud class action cannot be certified when individual reliance will be an issue." (citing *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973))).

95. See *Neder v. United States*, 527 U.S. 1, 25 (1999).

96. See 42 U.S.C. 1964(c) (2000); *Loiselle*, 303 F.3d at 103.

are never susceptible to certification because reliance is implicitly an element and it always destroys the requirement of the predominance of common issues. Along the way, both sides are prone to mix the analytical frameworks that courts have developed for recurring, yet very different, fact patterns. This makes it appear as if there are numerous and profound circuit splits on a range of fundamental issues. What one finds in the case law, however, is that different outcomes are generally attributable to different fact patterns. Indeed, one need only answer two critical questions to determine whether any particular case is likely to turn on individual questions of causation or reliance that would make certification inappropriate:

- (1) Were the alleged misrepresentations or omissions uniform or individualized?
- (2) Were the alleged misrepresentations or omissions directed to the plaintiff or to a third party?

In light of these questions, discussions as to whether RICO requires a showing of reliance in any or all circumstances or whether the plaintiff in a RICO case must always be the party to whom the misrepresentation was made will never yield useful results. In fact, the reliance imbroglio often obscures a fundamental issue: Should any court, in evaluating a motion to certify a RICO-fraud case as a class action, dismiss evidence that members of a putative class did not rely on the facts allegedly misrepresented (or knew the facts and had an opportunity to act in avoidance)?⁹⁷ Framed in this manner, the answer is plainly no. A lack of reliance should never be deemed irrelevant to the question of whether misrepresentations or omissions have caused injury. Accordingly, nearly all courts recognize that the presence of individual issues of reliance destroys predominance under Rule

97. See, e.g., *Summit Props., Inc. v. Hoechst Celanese Corp.*, 214 F.3d 556, 560 n.19 (5th Cir. 2000) ("If the relevant decisionmakers [sic] knew the limitations of the product but would have bought it anyway because of its low price, for example, the fraud would not have been a 'but for' cause of the plaintiffs' damages.").

23(b)(3).⁹⁸ Finally, case law prohibits analyzing certifiability strictly in terms of reliance.⁹⁹

1. **Certifiable RICO-Fraud Claims Must Not Turn on Individualized Misrepresentations That Raise Individual Causation Questions**

Many courts have recognized that in a direct misrepresentation case common issues will not predominate if allegedly fraudulent statements are not uniform (or nearly so). This observation is consistent with—even inherent in—Rule 23's predominance requirement:

It is only where . . . predominance exists that economies can be achieved by means of the class-action device. In this view, a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action, and it may remain so despite the need, if liability is found, for separate determination of the damages suffered by individuals within the class. On the other hand, although having some common core, a fraud case may be unsuited for treatment as a class action if there was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed.¹⁰⁰

In the RICO context, the predominance element of Rule 23(b)(3) means that proof of a central, coordinated scheme to de-

98. See, e.g., *Basic Inc. v. Levinson*, 485 U.S. 224, 242 (1988) ("Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones."); *Johnston v. HBO Film Mgmt., Inc.*, 265 F.3d 178, 194 (3d Cir. 2001) (stating that where "plaintiffs were not entitled to a presumption of reliance," the district court "did not abuse its discretion in concluding the plaintiffs failed to establish the predominance requirement of Rule 23(b)"); *Broussard v. Meineke Disc. Muffler Shops, Inc.*, 155 F.3d 331, 342 (4th Cir. 1998) ("[B]ecause reliance 'must be applied with factual precision,' plaintiffs' fraud and negligent misrepresentation claims do not provide 'a suitable basis for class-wide relief.'" (quoting *Jensen v. SIPCO, Inc.*, 38 F.3d 945, 953 (8th Cir. 1994))).

99. It is in service of a false dichotomy to examine certifiability strictly in terms of reliance. Case law itself refutes any such contention. In *Loiselle* for example, the district court denied class certification prior to trial, even though it applied a non-reliance standard that the First Circuit ultimately endorsed on appeal. See *Loiselle*, 303 F.3d at 104; *Sys. Mgmt., Inc. v. Loiselle*, 138 F. Supp. 2d 78, 81 (D. Mass. 2001). Conversely, in *Chisolm v. TranSouth Financial Corp.*, the district court certified a class, even though the Fourth Circuit had held (in an earlier phase of the case) that reliance was an element of the plaintiff's RICO-fraud claim. See *Chisolm v. TranSouth Fin. Corp.*, 95 F.3d 331, 337 (4th Cir. 1996); *Chisolm v. TransSouth Fin. Corp.*, 184 F.R.D. 556, 563 (E.D. Va. 1999). These cases belie the assertion that a court's view of reliance automatically determines whether RICO-fraud claims can be certified.

100. FED. R. CIV. P. 23(b)(3) advisory committee's note (1966 amendment), reprinted in U.S.C.S., COURT RULES: FEDERAL RULES OF CIVIL PROCEDURE RULE 23, at 12-13 (Lexis 1998).

fraud is not sufficient to establish liability across the board for fraudulent misrepresentation. Rather, to recover for fraudulent acts, “even if that fraud is the result of a common course of conduct, each plaintiff must prove that he or she personally received a material misrepresentation, and that his or her reliance on this misrepresentation was the proximate cause of his or her loss.”¹⁰¹

This requirement thus suggests a touchstone for separating non-certifiable fraud claims from potentially certifiable fraud claims:

Fraud actions must . . . be separated into two categories: fraud claims based on uniform misrepresentations made to all members of the class and fraud claims based on individualized misrepresentations. The former are appropriate subjects for class certification because the standardized misrepresentations may be established by generalized proof. Where there are material variations in the nature of the misrepresentations made to each member of the proposed class, however, class certification is improper because plaintiffs will need to submit proof of the statements made to each plaintiff, the nature of the varying material misrepresentations, and the reliance of each plaintiff upon those misrepresentations in order to sustain their claims.¹⁰²

This paradigm provides a useful method for winnowing cases that are hopelessly uncertifiable because they turn on individualized representations that necessarily raise individual questions of causation for trial. The remaining cases, particularly those based on fairly standard representations, may or may not be certifiable, depending on the ease with which receipt of (and causation of injury by) a representation can be proven.¹⁰³ The point here is that “[o]nly if class members re-

101. *Moore v. PaineWebber, Inc.*, 306 F.3d 1247, 1253 (2d Cir. 2002); *see also* *Gibbs Props. Corp. v. Cigna Corp.*, 196 F.R.D. 430, 439 (M.D. Fla. 2000) (declining to certify class, even though plaintiffs had identified a practice of overcharging “each and every” putative class member).

102. *Moore*, 306 F.3d at 1253.

103. *Id.* at 1255. Plaintiffs have advanced—with limited success—a variety of theories to overcome the obstacles that remain in a case based on standard representations. Some have adverted to the fraud-on-the-market theory approved in *Levinson*, 485 U.S. at 241–42. “[I]n an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements.” *Id.* (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160–61 (3d Cir. 1986)). But most courts have declined to apply the doctrine outside the securities context. *See, e.g.*, *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 666 (9th Cir. 2004); *Gunnells v. Healthplan Servs.*, 348 F.3d 417, 435 (4th Cir. 2003); *Sikes v. Teleline, Inc.*, 281 F.3d 1350, 1362 (11th Cir. 2002). *But see In re Sumitomo Copper Litig.*, 995 F. Supp. 451, 457–58 (S.D.N.Y. 1998). This case states,

In civil RICO claims, [the Second] Circuit has required a “causal connection between the prohibited conduct and plaintiff’s injury.” . . . When the predicate acts or mail and/or fraud are alleged, “to establish the required causal connection,

ceived materially uniform misrepresentations can generalized proof be used to establish any element of the fraud."¹⁰⁴

2. Plaintiffs May Establish a RICO-Fraud Claim Based on Third-Party Misrepresentations

The second question in limited circumstances involves cases falling into two sub-categories: (1) those involving direct misrepresentations to the plaintiff and (2) those involving misrepresentations to a third party. A good starting point for the discussion is *Sandwich Chef of Texas, Inc. v. Reliance National Indemnity Insurance Co.*,¹⁰⁵ a case involving allegations of both direct and third-party fraud. In that case, the district court certified a nationwide class of worker's compensation policyholders whose insurers had allegedly overcharged them.¹⁰⁶ The Fifth Circuit, however, found that the district court had done so "by eliminating, on substantive grounds, plaintiff-specific issues of reliance and causation."¹⁰⁷ An analysis of the facts and law leading to this holding reveals a scope of inquiry that properly focuses on how causation is to be tried.

The plaintiff alleged that 141 casualty insurers committed mail and wire fraud over a fourteen-year period by passing the cost of assessments that states made on them (referred to in the opinion as "residual market loads" or "RMLs") onto their insureds without first

the plaintiff [is] required to demonstrate that the defendant's misrepresentations were relied on."

Id. (citations omitted). See generally SMITH & REED, *supra* note 9, ¶ 6.05. So limited to securities cases, this theory is of no practical utility because the Private Securities Litigation Reform Act of 1995 removed most securities violations from RICO's ambit. Pub. L. No. 104-67, para. 107, 109 Stat. 737, 758 (1995). Other plaintiffs point to the presumption of reliance articulated in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153-54 (1972) ("[P]ositive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision."). Still, others have convinced a few district courts that reliance was obvious or self-proving. See, e.g., *Chisolm*, 184 F.R.D. at 563; *Spark v. MBNA Corp.*, 178 F.R.D. 431, 435-36 (D. Del. 1998). For the most part, though, circuit courts have declined to adopt any of these causation shortcuts. But see *Klay v. Humana*, 382 F.3d 1241, 1259 (11th Cir. 2004) (allowing reliance to be proven using circumstantial evidence).

104. *Moore*, 306 F.3d at 1255.

105. 319 F.3d 205 (5th Cir. 2003).

106. *Sandwich Chef of Tex., Inc. v. Reliance Nat'l Indem. Ins. Co.*, 202 F.R.D. 484, 487 (S.D. Tex. 2001). A slightly more elaborate discussion of this case can be found in the author's annual RICO update. See Randy D. Gordon, *RICO Update*, TEX. BUS. LITIG., Spring 2003, at 15, 15-16.

107. *Sandwich Chef*, 319 F.3d at 211.

obtaining regulatory authorization to do so.¹⁰⁸ The plaintiff also asserted that the defendants corrupted the National Council on Compensation Insurance, a licensed rating bureau and trade association, and used it as a racketeering enterprise to defraud policyholders and state insurance regulators.¹⁰⁹ The fraud-causation theory was thus two-fold: the defendants made false regulatory filings (fraud-on-the-regulator theory) and sent invoices that were inflated with unauthorized RMLs (invoice theory).¹¹⁰

As the court noted, the defendants had a different view of the facts, asserting that the named plaintiff was not only informed of, but also negotiated, its RML expenses and bargained for other terms that were not provided for in rate filings, which reduced the ultimate cost of its insurance.¹¹¹ Against this factual backdrop, the court turned to its legal analysis, which proceeded from the premise that “[t]he pervasive issues of individual reliance that generally exist in RICO-fraud actions create a working presumption against class certification.”¹¹² The district court had skirted this reliance/causation presumption in two ways, both of which purportedly flowed from the Fifth Circuit’s opinion in *Summit Properties Inc. v. Hoechst Celanese Corp.*¹¹³ In that case, the court held that proximate causation could be established where “a plaintiff has either been the target of a fraud or has relied upon the fraudulent conduct of the defendants.”¹¹⁴ The district court had thus concluded that the plaintiff “could establish proximate cause as to all the class members through common circumstantial evidence, either by the target wing or the reliance wing.”¹¹⁵

108. *Id.* at 211–12. The court explains this as follows:

Most employers purchase workers’ compensation coverage in the voluntary market. Those who cannot may obtain insurance through legislatively-established involuntary markets, sometimes called “residual markets,” “assigned risk markets,” or “assigned risk pools.” Some states require workers’ compensation insurance carriers to reinsure that state’s “residual markets,” which often results in additional costs to them when operating deficits occur. When residual market assessments dramatically increased, insurers responded by factoring residual market expenses in the price of their voluntary market expenses in the price of their voluntary market insurance. Insurance program documents identified these expenses as “residual market charges” (also known as “residual market loads” or “RMLs”).

Id.

109. *Id.* at 211.

110. *See id.*

111. *See id.* at 213.

112. *Id.* at 219.

113. 214 F.3d 556 (5th Cir. 2000).

114. *Id.* at 561.

115. *Sandwich Chef*, 319 F.3d at 219–20.

The Fifth Circuit first examined the reliance wing, which in the district court's view the plaintiff had met through its invoice theory. As the court described that theory, "[e]ach class member was overcharged by means of an inflated invoice that affirmatively misrepresented that the premium charged was the amount lawfully due."¹¹⁶ The plaintiff asserted that individual reliance was not an obstacle to certification because (1) the act of payment demonstrated reliance and (2) expert testimony could show that businesses rely on the accuracy of invoices.¹¹⁷ Regardless, the Fifth Circuit found this reasoning "legally flawed," principally because it did not account for the defendants' defenses.¹¹⁸ The district court did not adequately consider how the invoice theory would be tried in light of "evidence that might persuade the trier of fact that policyholders knew the amounts being charged varied from rates filed with regulators and that they had agreed to pay such premiums."¹¹⁹

The target claim, which the district court deemed satisfied by the fraud-on-the-regulator allegations, fared no better. The district court "reasoned that, under the target wing, individual reliance by class members was not an issue because reliance upon a fraudulent representation or omission by a third person was sufficient if the plaintiff was injured as a result."¹²⁰ Thus, the plaintiff "could establish proximate cause by demonstrating that the class members were injured by the regulators' reliance on defendants' misrepresentations and omis-

116. *Id.* at 220. When facing a fraud claim turning on the underlying legality or illegality of particular acts, one is well-advised to consider the source of law against which the conduct must be measured. This inquiry may reveal a thicket of state law that will have its own impact on certifiability. At least one court has denied certification of a RICO class on the following ground: "There is no federal insurance code; each State has its own insurance code, as well as its own Department of Insurance which in turn has its own administrative regulations." *Peoples v. Am. Fidelity Life Ins. Co.*, 176 F.R.D. 637, 642 (N.D. Fla. 1998). Thus,

[t]he trial of a class case would require the determination, as to each [insurance product] sale and under the law of each jurisdiction where the [insurance] product was sold, of whether the actions complained of were indeed unlawful—whether the representations made by the sales agents were misrepresentations—a question of tremendous complexity and difficulty.

Id.

117. *See* *Sandwich Chef of Tex., Inc. v. Reliance Nat'l Indem. Ins. Co.*, 202 F.R.D. 484, 500–01 (S.D. Tex. 2001).

118. *Sandwich Chef*, 319 F.3d at 220.

119. *Id.*; *see also* *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 665 (9th Cir. 2004) ("In this case, individualized reliance issues related to plaintiffs' knowledge, motivations, and expectations bear heavily on the causation analysis.").

120. *Sandwich Chef*, 319 F.3d at 221.

sions.”¹²¹ In holding that the district court erred in invoking the target theory to excuse individual proof of reliance, the Fifth Circuit made something more than a mere procedural point. By finding that (1) the target exception to RICO’s general reliance requirement “only comes into play when the plaintiff can demonstrate injury as a direct and contemporaneous result of fraud committed against a third party,”¹²² and (2) the target exception “has clear and constricted parameters that [the plaintiff] cannot satisfy in this case[,]”¹²³ the court tacitly held that the plaintiff’s target-based allegations failed to state a claim.

To further clarify the import of the direct versus third-party fraud distinction and how it bears on the issue of reliance, a brief review of other major cases proves helpful. As noted above, the first category involves allegations that a defendant made a misrepresentation directly to a plaintiff. There is no case in which a court has allowed a civil RICO-fraud plaintiff to recover in the face of evidence that it did not rely on the statements upon which it bases its claim.¹²⁴ No court, however, could properly permit recovery in this circumstance because causation is lacking if the plaintiff did not rely. Similarly, if the defendant made the alleged misrepresentation to the plaintiff but the plaintiff knew it to be false, then the misrepresentation could not cause any injury.¹²⁵

The second category of cases in the to-whom-the-representation-was-made category includes those in which a RICO-fraud plaintiff alleged that it was the target of the fraud and suffered a direct injury, even though the misrepresentation was to a third party. Again, there are no deep divisions among courts as to whether a plaintiff must rely on a misrepresentation made only to a third party. If the plaintiff never hears a misrepresentation, then he has no occasion to rely on it

121. *Id.*

122. *Id.* at 223.

123. *Id.* at 224.

124. This claim is based on the author’s research.

125. *Id.* at 218–19 (“Knowledge of the truth defeats a claim of fraud because it eliminates the deceit as the ‘but for’ cause of the damages.”). Cases cited for the contrary position typically address a different issue: whether reliance is an element of mail or wire fraud. They do not consider the role of reliance in proving causation under 18 U.S.C. § 1964(c). *See, e.g.,* United Healthcare Corp. v. Am. Trade Ins. Co., 88 F.3d 563, 571 n.5 (8th Cir. 1996) (noting that proof of mail or wire fraud does not require a showing of reliance); *Tabas v. Tabas*, 47 F.3d 1280, 1294 n.18 (3d Cir. 1995) (noting that “the mailings involved” do not need to be “relied upon”); *Armco Indus. Credit Corp. v. SLT Warehouse Co.*, 782 F.2d 475, 482 (5th Cir. 1986).

and the question of its reliance is moot.¹²⁶ Accordingly, the debate about reliance in the third-party context quickly collapses into one about "convergence"¹²⁷—that is, into assertions that some circuits will not permit RICO-fraud cases based on misrepresentations to third parties.¹²⁸ Although there is dictum suggesting that some circuits allow recovery whereas others do not,¹²⁹ careful readings reveal that in actuality circuit court decisions do not turn on the existence of a supposed convergence rule.¹³⁰

126. This does not mean that the reliance of the third party is irrelevant. *See, e.g., County of Suffolk v. Long Island Lighting Co.*, 907 F.2d 1295, 1311 (2d Cir. 1990) (suggesting that while it was not necessary for the plaintiff to have relied on the defendant's misrepresentations, the *third party* must have relied on them—otherwise the misrepresentations could not logically have caused the plaintiff's injury).

127. Convergence is the principle that the injured person and the deceived person be the same. *See SMITH & REED, supra* note 9, ¶ 9.05[2][a], at 9-59.

128. After *McNally v. United States*, 483 U.S. 350 (1987), some courts relying on a convergence theory required mail fraud plaintiffs to allege that the party deceived by the defendant's conduct was also the party injured. The seminal cases are pure mail or wire fraud cases—they do not have a RICO overlay. *See, e.g., United States v. Evans*, 844 F.2d 36, 38–40 (2d Cir. 1988). Thus, in RICO cases there is good reason to believe that convergence goes to the question of whether there is a predicate act, not to whether there is causation under § 1964(c).

Some courts make the convergence-as-mail-fraud-element distinction fairly explicit, discussing, for example, indirect fraud both in terms of causation under § 1964(c) and of convergence under the mail fraud statute. *See, e.g., Israel Travel Advisory Serv., Inc. v. Israel Identity Tours, Inc.*, 61 F.3d 1250, 1257–58 (7th Cir. 1995). Furthermore, even many of the courts that somewhat conflate the two inquiries under a "causation" banner do so in a way that still requires a separate analysis for each of the constituents *and* makes it clear that a bifurcated causation analysis is required because the predicate act alleged is mail or wire fraud. Unfortunately, though, these cases often confuse (or use interchangeably) reliance, which is not an element of statutory fraud, with convergence. For example, *Chisolm* states: [W]here the predicate act giving rise to civil liability under RICO was alleged to have been mail fraud, prospective plaintiffs must, in order to demonstrate their standing to sue, plausibly allege both that they detrimentally relied in some way on the fraudulent mailing and that the mailing was a proximate cause of the alleged injury to their business or property.

Chisolm v. TranSouth Finance Corp., 95 F.3d 331, 337 (4th Cir. 1996) (citation and footnote omitted); *see also Lifschultz Fast Freight, Inc. v. Consol. Freightways Corp.*, 805 F. Supp. 1277, 1292, 1294 (D.S.C. 1992), *aff'd*, 998 F.2d 1009 (4th Cir. 1993) (citing the same passage from *Mylan Laboratories, Inc. v. Akzo, N.V.*, 770 F. Supp. 1053, 1074 (D. Md. 1991), to support both reliance and convergence points).

129. *See Evans*, 844 F.2d at 39, 40 (stating that "[i]f a scheme to defraud must involve the deceptive obtaining of property, the conclusion seems logical that the deceived party must lose some money or property," but also stating that "the case before us today does not require us to decide this general question"); *Corcoran v. Am. Plan Corp.* 886 F.2d 16, 20 (2d Cir. 1989) (referring to the *Evans* language as dictum and declining to follow it).

130. The classic scenario where the target of fraud is the plaintiff, but misrepresentations are made to third parties involves falsehoods intended to lure customers from the target to the defendant. Courts have repeatedly found this scenario actionable because misrepresentations by a competitor to a plaintiff's customers can be the proximate cause of

For the proposition that reliance is irrelevant to proof of a civil RICO case based on third-party fraud, many point to *Systems Management, Inc. v. Loiselle*.¹³¹ The *Loiselle* plaintiffs alleged that the defendant-contractor misrepresented to a community college that the contractor was paying the plaintiff employees no less than the statutorily prescribed minimum wage.¹³² They further contended that these misrepresentations proximately caused their injury by depriving the college of information needed to enforce the contractor's duty to pay the minimum wage.¹³³ The First Circuit asserted the viability of a theory of RICO causation on these facts,¹³⁴ but the case is slender authority upon which to rest broad pronouncements as to the general certifiability of RICO-fraud claims. This is so because the circuit court considered the case after the district court had found *as a matter of fact* that the plaintiffs lacked sufficient knowledge to defeat causation.¹³⁵ Indeed, only two of eight plaintiffs were able to prove at trial that the scheme caused them injury.¹³⁶ Thus, the case stands for little more than that a plaintiff can establish a *prima facie* case of fraud based on misrepresentations to a third party. It says nothing about the ultimate success of this type of claim, especially in cases in which the plaintiff may know that the facts are not as represented to the third party. Nor does it say whether such a case involving individualized knowledge may proceed as a class action.¹³⁷

Cases cited for the proposition that some circuits require convergence are generally consistent with *Loiselle* when considered in light of their facts. For example, in *Central Distributors of Beer, Inc. v. Conn.*,¹³⁸ the plaintiff was not the target of the alleged fraud. Indeed, "the re-

RICO injury. Conceptually, these cases are fraudulent interference cases—tortious interference cases in which the tort is fraud. See *Commercial Cleaning Servs., LLC v. Colin Serv. Sys., Inc.*, 271 F.3d 374, 381–85 (2d Cir. 2001); *Proctor & Gamble Co. v. Amway Corp.*, 242 F.3d 539, 544–45 (5th Cir. 2001); *Brokerage Concepts, Inc. v. U. S. Healthcare, Inc.*, 140 F.3d 494, 521 (3d Cir. 1998); *Israel Travel*, 61 F.3d at 1257–58; *Mid-Atl. Telecom, Inc. v. Long Distance Servs., Inc.*, 18 F.3d 260, 263–64 (4th Cir. 1994).

131. 303 F.3d 100 (1st Cir. 2002).

132. See *id.* at 101–02.

133. See *id.* at 101–03.

134. See *id.* at 103–04.

135. See *Sys. Mgmt., Inc. v. Loiselle*, 112 F. Supp. 2d 112, 119 (D. Mass. 2000). The First Circuit did not even discuss the *Holmes* direct-relation test or the issue of causation because the defendant did not contest causation. See *Loiselle*, 303 F.3d at 103–04.

136. See *Sys. Mgmt., Inc. v. Loiselle*, 138 F. Supp. 2d 78, 97–99 (D. Mass. 2001).

137. The district court in *Loiselle* twice denied a motion for class certification. *Id.* at 81 ("On January 18, 2000, and again on May 15, 2000, the Court rebuffed two attempts to certify the case as a class action.").

138. 5 F.3d 181 (6th Cir. 1993).

cord demonstrate[d] that the [defendants] were not even aware of the existence of [the plaintiffs] until after the commencement of" the litigation.¹³⁹ Thus, the plaintiff could never demonstrate any claim that the defendants intended to harm it. In other words, the plaintiff had an impossible case because it could not show that any fraud was aimed at it.

*Pelletier v. Zweifel*¹⁴⁰ is also less problematic than some would argue. Although the Eleventh Circuit in *Pelletier* stated that a RICO plaintiff "must have relied to his detriment on misrepresentations made in furtherance of [a] scheme,"¹⁴¹ the plaintiff alleged that the defendant in fact made misrepresentations *directly to him*.¹⁴² The court's statement is therefore dictum in the context of third-party misrepresentations.¹⁴³

General rules are hard to tease from these cases. But that is really the point: courts are best served when they carefully and individually evaluate the factual basis of third-party fraud claims.

B. Courts Make Mistakes When They Fail to Follow the *Holmes* Directive to Consider Facts Rather than Bright-line Rules

None of this is to suggest that courts at either end of the spectrum always get the causation analysis right when they are faced with the decision to certify or not certify a class. When they are wrong, it is usually because they have either forgotten *Holmes's* admonition to consider facts rather than bright-line rules or because they failed to consider how a particular case could be tried. The following examples illustrate these points.

Although not a class action, *Special Purpose Accounts Receivable Co-operative Corp. v. Prime One Capital Co.*¹⁴⁴ presents a case of the former. There, the court seized on the Eleventh Circuit's "restrictive" view of

139. *Id.* at 184.

140. 921 F.2d 1465 (11th Cir. 1991).

141. *Id.* at 1499-1500.

142. *Id.* at 1500.

143. *Johnson Enterprises of Jacksonville, Inc. v. FPL Group, Inc.*, 162 F.3d 1290, 1318 (11th Cir. 1998), which quotes *Pelletier*, is also consistent with the general principles set forth in the text. As in *Conn*, the evidence showed that the plaintiff was not the target of the fraudulent scheme. *See id.* at 1300-01 (describing "greenmail" scheme aimed at third parties). Even worse for the plaintiff, the court held that no misrepresentation injured it, concluding that "[i]f anything, the misrepresentations inured to [the plaintiff's] benefit." *Id.* at 1318. In other words, applying *Holmes*, the court decided that the plaintiff's theory of causation and injury made no sense. *See id.*

144. 202 F. Supp. 2d 1339 (S.D. Fla. 2002).

RICO's causation requirement,¹⁴⁵ including the often-repeated (but rarely controlling) statement that "a plaintiff lacks standing to assert, as the basis for mail fraud, misrepresentations directed toward another person or entity."¹⁴⁶ Unquestioning acceptance of this proposition ignores the fact-sensitive inquiry that *Holmes* demands. True, one can imagine a host of scenarios in which third-party misrepresentations were not the cause-in-fact of injuries, let alone the direct cause. *Prime One* does not, however, present one of those scenarios.

To the contrary, *Prime One* arises from facts that most courts would find sufficient to state the causation element of a fraud claim under the common law, federal fraud statutes, and RICO. In *Prime One* the defendants allegedly misrepresented to third parties that they were authorized to collect lease and vehicle-sales proceeds.¹⁴⁷ The plaintiffs claimed that this fraud allowed the defendants to convert millions of dollars of lease proceeds belonging to the plaintiffs.¹⁴⁸ Properly viewed, these allegations should be sufficient to demonstrate RICO causation because (1) the plaintiffs were the target of the fraud

145. Some have argued that the Eleventh Circuit's requirement that each class member demonstrate reliance amounts to a per se ban on fraud-based RICO class actions. See Hanzman, *supra* note 31, at 37. That court, however, recently proved the fear unwarranted. In *Klay v. Humana, Inc.*, the court let stand the certification of a RICO-fraud class, even though the case was of such massive scope that it "threatens to degenerate into a Hobbesian war of all against all." 382 F.3d 1241, 1276 (11th Cir. 2004). *Klay's* holding was ultimately based on its belief that other issues tended to predominate and that "circumstantial evidence . . . can be used to show reliance is common to the whole class." *Id.* at 1259.

The factual crux in *Klay* was that the defendant HMOs systematically underpaid the plaintiff physicians for their services through use of, for instance, rigged computer systems. At the same time, however, "the defendants repeatedly claimed they would reimburse the plaintiffs for medically necessary services . . . and sent the plaintiffs various . . . forms claiming they had actually paid the plaintiffs the proper amounts." *Id.* From this the court concluded that

[i]t does not strain credulity to conclude that each plaintiff, in entering into contracts with the defendants, relied upon the defendants' representations and assumed they would be paid the amounts they were due. A jury could quite reasonably infer that guarantees concerning the physician pay—the very consideration upon which those agreements are based—go to the heart of these agreements, and that doctors based their assent upon them.

Id.

This is plainly an unusual scenario, and one may safely presume that it does not represent a sea of change in Eleventh Circuit class certification jurisprudence. It does nevertheless effectively demonstrate that that circuit is not as doctrinaire as some had supposed. Of course, it remains to be seen whether the district court—which the circuit dubbed "a veritable Leviathan"—can actually try the case. See *id.* at 1276.

146. *Prime One*, 202 F. Supp. 2d at 1349 (quoting *Byrne v. Nezhad*, 261 F.3d 1075, 1110 (11th Cir. 2001)) (emphasis omitted).

147. *Id.* at 1348.

148. *Id.*

(it was plaintiffs' money that defendants stole) and (2) the injury to plaintiffs was a direct and contemporaneous result of the misrepresentations (the money moved straight into defendants' pockets instead of plaintiffs'). Under *Holmes*, no more should be required.

At the other end of the spectrum is the Seventh Circuit's recent decision upholding class certification in *Carnegie v. Household International, Inc.*¹⁴⁹ The underlying litigation arose out of tax refund anticipation loans.¹⁵⁰ Some consumers do not want to wait for tax refunds; predictably, enterprising lenders have moved in to fill the temporal void between tax return filing and IRS refund.¹⁵¹ Although the lender provides the money, a tax preparer arranges the loan.¹⁵² The plaintiffs in *Carnegie* alleged that they were not told that the lender paid the tax preparer a fee or that the tax preparer received an ownership interest in the loan.¹⁵³ The basic claim was that the defendants led plaintiffs to believe that the tax preparer was their fiduciary when in fact the tax preparer was self-dealing.¹⁵⁴

In 1999, the named plaintiff in one of numerous class-action suits entered into a twenty-five million dollar global settlement, which the district court approved.¹⁵⁵ The Seventh Circuit reversed because the court was "concerned that the settlement might have been the product of collusion between the defendants, eager to minimize their liability, and the class lawyers, eager to maximize their fees."¹⁵⁶ On remand, the district judge to whom the case was reassigned disapproved of the settlement, concluding that it was indeed unfair.¹⁵⁷ That judge subsequently certified a contested class, which gave rise to petitions to appeal under Rule 23(f).¹⁵⁸ The Seventh Circuit granted the petitions to consider questions involving, first, the procedures and criteria for converting a settlement class to a litigation class and, second, the bearing of judicial estoppel on class action litigation.¹⁵⁹ During the course of its opinion, however, the court, in a thinly reasoned

149. 376 F.3d 656 (7th Cir. 2004).

150. *See id.* at 658.

151. *See id.* at 658–59.

152. *Id.* at 659.

153. *See id.*

154. *Id.*

155. *See* Zawikowski v. Beneficial Nat'l Bank, No. 98 C 2178, 2000 WL 1051879, at *12 (N.D. Ill. July 28, 2000).

156. *Carnegie*, 376 F.3d at 659. The Seventh Circuit's reversal is found at *Reynolds v. Beneficial National Bank*, 288 F.3d 277 (7th Cir. 2002).

157. *See* Reynolds v. Beneficial Nat'l Bank, 260 F. Supp. 2d 680, 695 (N.D. Ill. 2003).

158. *See Carnegie*, 376 F.3d at 658.

159. *See id.*

stretch of the opinion, made some rather astonishing and unfortunate observations about the certifiability of fraud claims in which questions of causation and reliance are in play.

After concluding that defendants were judicially estopped to contest certification grounds that they had urged vis-à-vis the earlier settlement class, the court turned to the crowning distinction between settlement and litigation classes—manageability.¹⁶⁰ Apparently, the defendants argued nothing against manageability other than to refer to millions of class members, which the court deemed “no argument at all.”¹⁶¹ Seemingly to convince itself that the putative class of seventeen million would be manageable, the court engaged in a bit of sophistry. First, the court noted that “there is a big difference from the standpoint of manageability between the liability and remedy phases of a class action. The number of class members need have no bearing on the burdensomeness of litigating a violation of RICO.”¹⁶² So far, so good. But the court essentially stopped there and built its conclusion on an incomplete premise:

Whether particular members of the class were defrauded and if so what their damages were are another matter, and it may be that if and when the defendants are determined to have violated the law separate proceedings of some character will be required to determine the entitlements of the individual class members to relief. That prospect need not defeat class treatment of the question whether the defendants violated RICO. Once that question is answered, if it is answered in favor of the class, a global settlement along the lines originally negotiated (though presumably with dif-

160. *Id.* at 660. The court states:

The defendants are correct, however, that a class might be suitable for settlement but not for litigation. The class might be unmanageable if the case were actually tried yet manageable as a settlement class because the settlement might eliminate all the thorny issues that the court would have to resolve if the parties fought out the case.

Id.

161. *Id.* at 661. The court further states:

The more claimants there are, the more likely a class action is to yield substantial economies in litigation. It would hardly be an improvement to have in lieu of this single class action seventeen million suits each seeking damages of \$15 to \$30. The rejected settlement capped damages at these amounts for single and multiple RALs respectively, and while the amounts may be too low they are indicative of the modest stakes of the individual class members. The *realistic* alternative to a class action is not seventeen million individual suits, but zero individual suits, as only a lunatic or a fanatic sues for \$30. But a class action has to be unwieldy indeed before it can be pronounced an inferior alternative—no matter how massive the fraud or other wrongdoing that will go unpunished if class treatment is denied—to no litigation at all.

Id.

162. *Id.*

ferent dollar figures) will be a natural and appropriate sequel. And if there is no settlement, that won't be the end of the world. Rule 23 allows district courts to devise imaginative solutions to problems created by the presence in a class action litigation of individual damages issues.¹⁶³

What did the court miss here? Section 1964(c). Indeed, the court leapt from the question of whether § 1962(c) was violated to the question of damages,¹⁶⁴ without considering how seventeen million individuals would prove that they had been injured "by reason of" that violation.¹⁶⁵ Given the alleged misrepresentations, statements designed to make class members believe that their tax preparers were fiduciaries, it seems unlikely that causation could be proven at trial other than on an individual basis. At the end of the day, this case may represent nothing more than a court's reluctance to let a group of defendants who were willing to pay twenty-five million dollars walk away without actually paying a dime. Unfortunately, though, if the case is left uncorrected, it will no doubt create mischief for years to come.

Civil RICO cases are often of enormous scope, especially when they are pleaded as class actions against a large group of defendants. Courts understandably look for general standards that will help them circumscribe blockbuster cases. Marginal cases like *Prime One* and *Carnegie* show, however, the folly of analytical shortcuts that ignore the rigorous factual evaluation that *Holmes* requires in every RICO case.

163. *Id.* (citations omitted).

164. Although quantifying the *amount* of damages that a plaintiff suffered (after demonstrating all other elements of its claim) need not prove an insurmountable obstacle to certification, this is not so where the broader question of injury is at issue. See *In re Merrill Lynch Sec. Litig.*, 191 F.R.D. 391, 396, 398 (D.N.J. 1999) (class certification denied because "proof" of damages—as opposed to "calculation" of damages—required individualized decision), *aff'd*, 259 F.3d 154 (3d Cir. 2001).

165. See, e.g., *Sikes v. Teleline, Inc.*, 281 F.3d 1350, 1361 (11th Cir. 2002). The court stated that even if plaintiffs could show common RICO violations, they would "still have to show, on an individual basis, that they relied on the misrepresentations." *Id.* (quoting *Andrews v. Am. Tel. & Tel. Co.*, 95 F.3d 1014, 1025 (11th Cir. 1996)) (emphasis added); *Expanding Energy, Inc. v. Koch Indus., Inc.*, 132 F.R.D. 180, 183 (S.D. Tex. 1990). The court in *Expanding Energy* states:

It is beyond argument that Koch suffered shortages from time to time as well as overages, and that some of the interest owners received consistent, honest measurements [of their crude oil]. The impropriety of a class action in these circumstances seems to be obvious, since the class cannot show class-wide injury. Perhaps some of the members of the proposed class can show injury for at least some of their sales to Koch, but that fact argues against certifying a class at all.

132 F.R.D. at 183.

Conclusion

Causation is the lynchpin of any civil RICO case. When a case sounds in fraud, the question of how causation must be pled and proven too often evolves into a pointless argument over whether reliance bears on this question. As this Article demonstrates, there are better ways to frame the causation analysis, at least in the most common types of cases. Reliance does not completely disappear, but its relative importance is determined by the paradigm applicable to the facts of the case at hand (for example, a consideration of direct versus third-party representations), not a blanket pronouncement that it is relevant to all RICO cases. This squares with the sort of fact-sensitive analysis that the *Holmes* court envisioned and pays due attention to the RICO statute's structure.